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VOL. CLIII NO. 39 Friday, February 26, 1988

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The Washington unemployment agency should experience a dramatic reduction in its operating costs. If it doesn't, then we are not doing our job right.

Martin Dukler, vice president of TransFirst Corp., which will provide the distribution network for the state's unemployment benefits. [Page 3]

Bid for Irving Wins State Banking Board Nod

Company Vows to Continue Fight Against Hostile Takeover by Bank of New York

By GORDON MATTHEWS

NEW YORK — The New York State Banking Board on Thursday voted unanimous approval of Bank of New York Co.'s hostile bid for Irving Bank Corp. But Irving said it would continue to fight the takeover attempt, which if successful would be the first unwelcome acquisition of a major bank.

Bank of New York said it was "pleased and gratified" with the regulatory ruling, which came exactly five months after its bid for Irving was unveiled.

Federal Reserve Board approval is still required before Bank of New York can proceed with its $1.1 billion takeover. The board met Wednesday and Thursday on the matter. The Thursday meeting ended at 3 p.m., but by late in the afternoon no decision had been made public. It was not clear if a ruling would be announced Thursday evening.

News of the state banking board's 13-to-0 decision at midmorning sent the price of Irving's stock up sharply. In afternoon trading, Irving was quoted at $53.75, up $3.25 from Wednesday's close. Bank of New York Co.'s shares were unchanged at $29.625.

Irving said in a statement it "will continue to resist the Bank of New York's hostile takeover attempt." The state approval, it asserted, "does not change the nature of the proposal, which makes no business sense and is not in the best interests of Irving shareholders."

In an indication that it may be considering legal action, Irving charged that the state decision "appears clearly to run counter to the statutory standards for such approvals which the Banking Board is required to follow."

With full regulatory approval, the stage could be set for a proxy battle between two of New York's most venerable banks. Bank of New York was formed in 1784 by Alexander Hamilton, the nation's first Treasury secretary; Irving was founded in 1811 and named after Washington Irving, the author and diplomat.

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First Wisconsin Restates Earnings To Register Loss

By JOHN P. FORDE

NEW YORK — First Wisconsin Corp. and Peat Marwick Main & Co. this week were reminded of the old saying that close only counts in horseshoes and hand grenades, not financial accounting.

Wisconsin's largest bank holding company will restate its 1987 earnings to show a $49 million loss after its accounting firm changed its mind on when to recognize income from the sale of a building.

A spokeswoman for the Milwaukee-based holding company said on Thursday that Peat Marwick, its auditor, decided that $57 million in income from the sale/leaseback of its headquarters must be included in

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Auto Lenders File Formal Complaint Protesting Dealer Financing Practices

By BARBARA A. REHM
Washington Bureau

WASHINGTON — Trade groups representing independent bankers and credit unions filed a formal complaint Thursday charging the credit subsidiaries of three major U.S. automakers with unfair and deceptive advertising.

The Independent Bankers Association of America and the Credit Union National Association asked the Federal Trade Commission to investigate the advertising practices of General Motors Acceptance Corp., Chrysler Financial Services, and Ford Motor Credit Co.

"The cut-rate financing offered by the captive subsidiaries is a blatant violation of the FTC Act, catching consumers in an illegal bait-and-switch operation," the groups said.

Spokesmen at Ford Credit and GMAC said they had not seen the complaint and could not comment. No one authorized to speak for Chrysler Financial could be reached yesterday.

A commission spokeswoman said the agency's credit practices division will look into the complaint and decide whether a full investigation is warranted.

Finance companies are exercising growing control over new-car loans, the complaint said — reaching almost 38% by the end of 1987 — while the share held by banks, thrifts, and credit unions is declining. How much of the 38% belongs to finance company affiliates of the car manufacturers is not indicated.

The bank and credit union trade groups argue that buyers are lured to car showrooms by advertisements promising low interest rates on loans from the manufacturer's finance com-

Auto Lenders: Page 15 ➤

More financial institutions failed in 1987 than in any year since the Great Depression.

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Dollar Dominates Swaps, Survey Shows

Deals in US Currency Outstrip Yen, Deutsche Mark by Far

By LISABETH WEINER
Midwest Bureau

CHICAGO — Interest rate and currency swaps totaling $225 billion were executed during the first half of 1987, according to a survey released by the International Swap Dealers Association.

While the association has kept track of interest rate swap activity since 1985, this is the first time the group has provided data on currency swaps.

"There was absolutely great demand for the currency swap numbers," said Patrick de Saint-Aignan, chairman of the International Swap Dealers Association and a managing director at Morgan Stanley & Co.

"When we do release the next survey, we will also include information on the amount of swaps [currency and interest rate] outstanding, as well as production. I think outstandings will be more than $1 trillion for swaps with average maturities of three years or more."

Swaps, developed in 1982, are corporate finance tools used by companies to hedge risk, reduce borrowing costs, or raise capital in foreign currency markets. Interest rate and currency swaps are agreements between counterparties to exchange debt obligations.

"These new figures furnish additional evidence that swaps are an increasingly dominant presence throughout the global marketplace," said Mr. Saint-Aignan. "Fueled by market volatility and currency fluctuations, the swap market has become universally recognized by financial managers around the world as an effective means of hedging portfolios against risk."

The U.S. dollar dominates as the major currency used in swaps. The survey concluded that transactions involving the dollar totaled $178 billion for the first half of the year. The yen was second with $28 billion, followed by the deutsche mark at $17 billion.

Mr. Saint-Aignan said the dollar's dominance in swap is "consistent with the role of dollar financing in the total world picture. No market has the depth and liquidity of the dollar market." He added, however, that it is not surprising to see the strength of the dollar swap market compared with other currencies.

"In every capital market, there are local currency needs, but also some amount of dollar swapping is needed which adds up to a large number. It's also possible some nondollar major dealers did not take part in the survey, which would create a statistical bias — and this is something we will have to look at."

Interest rate swaps also continue to outpace currency swaps. Volume in dollar interest rate swaps reached $138.7 billion in the first half of the year, with yen volume at $13.7 billion and deutsche mark volume at $10 billion.

In currency swaps, U.S. dollar volume was $39.2 billion, yen volume was $14.4 billion, and deutsche mark volume was $6.8 billion.

The International Swap Dealers Association, which released the survey at its third annual conference in San Francisco, said that 10,936 swaps were booked in the first half of last year, broken down into 9,321 interest rate and 1,615 currency swap deals. The average contract value was $20 million for interest rate swaps and $27 million for currency swaps.

The swap group said 51 dealers, representing the most active traders in 13 currencies, took part in the survey conducted by Arthur Andersen & Co. ■

How Swaps Are Denominated

January 1987 - June 1987

Interest Rate Swaps	No. of Swaps	$ Equiv (Mil.)	Average Contract Value (Mil.)
US dollars	6,158	$138,740	$22.53
Australian dollars	772	3,824	4.95
Belgian francs	0	0	0.00
British sterling	593	9,349	15.77
Canadian dollars	107	2,077	19.41
Deutsche marks	727	10,009	13.77
Dutch guilders	12	142	11.83
European currency units	46	619	13.46
French francs	86	667	7.76
Hong Kong dollars	49	403	8.22
Japanese yen	591	13,741	23.25
New Zealand dollars	5	50	10.00
Swiss francs	175	1,922	10.98
Total	**9,321**	**$181,543**	
Currency Swaps			
US dollars	1,523	$39,157	$25.71
Australian dollars	276	5,349	19.38
Belgian francs	3	71	23.67
British sterling	80	2,516	31.44
Canadian dollars	87	2,388	27.45
Deutsche marks	205	6,803	33.19
Dutch guilders	25	990	39.60
European currency units	230	5,492	23.88
French francs	31	1,284	41.42
Hong Kong dollars	2	37	18.50
Japanese yen	424	14,407	33.98
New Zealand dollars	114	2,798	24.54
Swiss francs	229	5,780	25.24
Total	**3,229**	**$87,071**	

Source: International Swap Dealers Association Inc.

Minnesota Independents Reverse Position, Back Interstate Banking

By ANDREA BENNETT
Midwest Bureau

CHICAGO — Minnesota's independent bankers, traditionally among the most vocal opponents of interstate banking, switched their position this week to support opening the state to banks across the country.

The Independent Bankers of Minnesota announced the shift during hearings on a bill that would allow the state's banks to expand into 12 additional states, provided they have reciprocal legislation. The regional bill passed the Senate Commerce Committee on a voice vote Tuesday.

The independent bankers maintain that converting to nationwide banking is better than taking a piecemeal approach. The association plans to work to amend the regional bill and make it a national one, said Reese Doffing, vice president of administration for the trade group.

"The Legislature is going to be dealing with it year after year," Mr. Doffing said. "Why not do it all now?"

The independent bankers' new position, however, conflicts with that of the state's major bank holding companies, which say they need more time to prepare for full nationwide banking.

"Our position is there should be a gradual transition to nationwide banking that allows banks to prepare for [it]," said Becky Malkerson, vice president of government relations at First Bank System Inc., Minneapolis, a major supporter of the bill moving through the Senate.

The bill would add the the following states to Minnesota's region: Colorado, Idaho, Illinois, Kansas, Michigan, Missouri, Montana, Nebraska, Oregon, Utah, Washington, and Wyoming. It contains no trigger to nationwide interstate banking, Ms. Malkerson said.

Since July 1986 the state has allowed banks to expand into Iowa, North Dakota, South Dakota, and Wisconsin if they have reciprocal legislation. Only Wisconsin has such a law.

No Nationwide Banking Position

The Minnesota Bankers Association supports the regional legislation but has not taken a position on nationwide banking, said Bill Zwart, associate counsel for the group.

There appears to be enough legislative support to amend Minnesota's interstate banking law this year so that some states are added to the region, bankers said. The move by the independent bankers could increase support for adding a national trigger to the bill, they said.

In addition to expanding the bill to encompass nationwide banking, the independent bankers will ask for safeguards, such as concentration limits and minimum capital requirements for banks coming in the state, Mr. Doffing said. ■

2 Congressmen Unveil Separate Consumer Bills

By ROBERT M. GARSSON
Washington Bureau

WASHINGTON — Separate consumer rights bills introduced Thursday may provide a clue about the direction major banking legislation is taking in the House.

The two bills, from Rep. Charles E. Schumer, D-N.Y., and Rep. Joseph P. Kennedy 2d, D-Mass., were unveiled at a joint press conference complete with endorsements from Ralph Nader and other activists. The measures would direct banks to provide free services to the poor and would mandate increased monitoring of compliance with the Community Reinvestment Act.

The two lawmakers declined to say whether House Banking Committee Chairman Fernand J. St Germain, D-R.I., supports their bills. But Mr. Kennedy noted that the committee staff provided extensive help and that Mr. St Germain had been generally supportive. Banking committee staffers were present at the press conference as well.

The consumer bill would be Mr. Schumer's second contribution to banking legislation the committee is expected to consider next month. A bill introduced earlier would set permanent restrictions on insurance, securities, and real estate activities by banks.

Mr. St Germain has said little about the bill being drafted for committee consideration, but it is widely expected to follow the same direction as Mr. Schumer's bill. Close observers say committee staffers have encouraged that view.

A spokesman for the Consumer Bankers Association, stressing that he has not yet seen the fine print of either bill, said his organization objects to the major elements of both pieces of legislation.

No-Fee Checking for the Poor

The Schumer bill would require banks, thrifts, and credit unions to provide no-fee checking accounts for the poor and to issue identification cards at nominal cost, permitting government checks to be cashed without charge.

The bill mandates public disclosure of the geographic distribution of commercial loans by making such lending subject to the Home Mortgage Disclosure Act. It would establish voluntary organizations in each state to advocate consumer interests. Members would be solicited through inserts enclosed in monthly bank statements.

The Kennedy bill would establish a five-point rating scale for Community Reinvestment Act compliance. As a condition for approval of new powers — including powers currently authorized under the Bank Holding Company Act — an institution would be required to secure one of the two highest ratings. The reinvestment act ratings would be made public. Federal regulators would be required to establish a separate division of consumer affairs to develop rating standards and conduct reinvestment act examinations.

The rating system would evolve over five years so that a comparative approach could be taken, Mr. Kennedy said.

"Not all banks can be above average, so the regulators will have to make decisions about which banks perform better than others," he said. "Only the best should be allowed to get involved in nonbanking activities and interstate banking."

Mr. Schumer said the legislation is designed so that it can be attached to any bill reported out of the banking committee. ■

COMMENT

Moody's Actions Point Up Need for Agency Scrutiny

By DAVID C. CATES

MOODY'S INVESTORS Service became an outlaw last week, in my opinion. In its severe downgrades of most New York bank holding companies, the rating agency violated the public trust that its earlier reputation had earned for it. If there is a bright side to the damage, it is that peer review of rating agency world views and methods should now begin to limit the monopoly power over bank funding capacity these bureaucracies have so far been uncritically been awarded.

Let's begin with some history. In 1973, Moody's was the first to issue a bank holding company rating: Aaa on Bankers Trust New York Corp. Lewis Lapham of Bankers Trust had headed the industry committee that skeptically considered whether banks would cooperate with the agencies and finally decided to recommend such a posture. Within a few years, all money center bank holding companies and a few regionals had won triple-A ratings from Moody's or Standard & Poor's Corp. The agency theory at that time was that sheer size, coupled with market dominance; broad diversification of assets and funding; strong asset quality, liquidity, and capital; and reasonable profitability were required for a double-A or better.

Though the agencies understood from the outset (in advance of almost all other analysts) that the U.S. parent of a bank holding company had potential cash flow constraints to the extent it relied on bank subsidiaries, this awareness initially did not stand in the way of high bank holding company ratings.

Mr. Cates is president of Cates Consulting Analysts Inc., New York.

We should never forget that the major rating agencies are far from bloodless Olympians hurling abstract thunderbolts from above the clouds. The two are locked in mortal combat for leadership image and revenue.

— David C. Cates

In those early days, only a few curmudgeons were heard to mutter such sentiments as this: "Triple-As are fine, but what happens when they try to bring us down to a single-A or worse? We can then neither refuse nor contest the rating. Aliens now control our funding destiny." Naturally, such views were ridiculed and overruled.

Crises Created

Some downgrades have in fact precipitated crises. For example, Moody's dropped the commercial paper rating of Northern States Financial to a Prime-3 in 1976, which stopped a dealer-issued program in its tracks and caused the Comptroller to save a bank holding company in order to save a bank. A few years later, Moody's dropped the commercial paper rating of First Pennsylvania to a Prime-3, which impaired not only the holding company's finances but also affected the bank's own uninsured funding, thus creating the immediate crisis that led to federal assistance.

Whether they were merited or not in those instances (yes, they were), the point here is simply that rating downgrades by a major agency can have an enormous affect on the market, especially for banks and bank holding companies, whose funding is its raw material.

Following the high water mark of the late 1970s, when there were a dozen triple-A-rated domestic bank holding companies, Moody's and S&P began downgrades in earnest. Moody's Money Center Bank Review of March 1982 laid out much of the rationale for the series of downgrades of our largest banks since then.

Moody's was rightly troubled by three factors. There was the problem of Third World debt. There was uncertainty about the strategic retooling required of New York banks if they were to retain the Fortune 1000 (among other constituencies) for any source of income. And there was the asset-quality problem that arose from the banks' rush to expand their domestic lending in the middle market.

As the downgrades continued throughout the 1980s, large foreign banks began to win triple-A ratings. By early 1987, S&P or Moody's had awarded triple-As to about a dozen foreign-owned banks. Since then, they have lost some of their original luster with the rating agencies, but there are still 29 foreign banks rated triple-A, and 30 with double-A ratings.

Three other points may help explain why Moody's acted as it did. First, the Federal Deposit Insurance Corp.'s assistance last year in response to two near-failures in Oklahoma showed that the government would no longer bail out a holding company, as it did with Continental Illinois Corp. in 1984. Second, the rating agencies were almost certainly embarrassed by their misperception of — or laggard response to — the Continental Illinois situation.

And third, we should never forget that the major rating agencies are far from bloodless Olympians hurling abstract thunderbolts from above the clouds. The two are locked in mortal combat for leadership image and, like any business, for revenue. This, in turn, can breed career opportunism, with consequent risks of overstatement and conflict of interest.

Some Justified

I find no problem with two large aspects of the Moody's downgrades. First, some of them were probably justified, not because the economic reality behind financial services has recently changed, but simply because the previous ratings were still too high in relation to that reality. This "catch-up" effort should have led Moody's, in my opinion, to implement a pattern of minor downgrades such as S&P followed in its early February announcement.

Nor do I have a problem with Moody's relative assessment of the money center group. With some minor exceptions, I believe the agency is fair in its relative judgment of creditworthiness.

So where's the beef? If the pattern of continuing downgrades is justified to some degree, and if these are more or less applied as deserved, does not mere heavy-handedness become just a cosmetic question? On the contrary, I will single out four substantial issues to support my opinion that Moody's has acted unaccountably, and in a manner that cries out for public review.

• The dramatic and unprecedented severity of the money center downgrades falsely suggests that the economy has recently deteriorated, or is about to do so. The dramatic high points: J.P. Morgan & Co., the last domestic bank holding company with an Aaa rating, went to Aa. Bankers Trust New York Corp. lost its Aa as its new chief executive officer, Charles Sanford, was declaring that the company deserved to be rated Aaa. Several bank holding companies sank to Baa status, which the market insists on viewing as below investment grade (despite rating agency disclaimers to the contrary). The commercial paper of Manufacturers Hanover Corp. dropped to a potentially damaging Prime-3. Furthermore, several of the downgrades did not occur in the customary small increments, but skipped intermediate steps as to suggest some emerging crisis.

The question here is whether these stunning falls from grace are merited either by new environmental shifts as uniquely perceived by the Moody's analysts (e.g., Third World borrower deterioration), or by fundamental deterioration at the companies in question (recall that rating agency analysts are technically "insiders" and are privy to nonpublic information).

If neither, then the dramatic severity of the downgrades — viewed singly or as a composite — sends an alarming but false signal of new weakness. Signals like this can cause damage around the world at the hands of those who have no reason to understand the fine points of the rating agency tea ceremony.

• The unadjusted continuation of much higher credit ratings on a large group of foreign banks falsely implies some new and special weakness at the U.S. money centers. Maybe Moody's does believe that the foreign-owned international banks are relatively that much stronger than our own. Or perhaps a Moody's apocalyptic world view is just beginning to unfold, and the foreign banks are next. In any case, the immediate damage is to the worldwide image and funding power of the U.S.-owned international banks, and this can be real.

A broader question here has to do with cross-group relative standing, always a thorny challenge to a multi-industry rating agency. Somehow all the ratings have to make sense — certainly they are willy-nilly interpreted as making sense — across all industries and within entire industries. Thus a Citicorp "A" from Moody's should be comparable in credit quality to a Federal Paper Board "A", a Merrill Lynch & Co. "A", and a Huntington Bankshares "A". An "A" must also indicate greater strength than some "Baa" chemical manufacturer, and less strength than a Credit Suisse "Aaa". Absurd as these equivalences may be, one cannot ignore their power.

In the pursuit of an elusive common standard by which to judge all industries and all companies, the rating agencies seem to have decided that the median U.S. money center bank holding company rating is "A", whereas the median foreign bank rating is "Aa". Are these differences real, or are they the product of an eccentric world view, a dogmatic analytic methodology, or some unconscious initiative rooted in other factors?

• The J.P. Morgan downgrade to "Aa" where the lead bank was reaffirmed as a "Aaa" smacks of a doctrinaire Moody's reversion to an ancient prejudice against the U.S. bank holding company. True, a bank holding company parent lacks the cash flow resources of an operating bank. In an overall weak situation, the credit rating of a bank holding company should be a good deal lower than that of an underlying bank. In Morgan's case, however, Moody's reaffirms Morgan Guaranty Trust Company of New York as "Aaa"! This must mean that the dividend to the parent is foreseeably secure. The parent, meanwhile, has deliberately avoided double leverage — which can at times strain bank dividends — and it has deliberately built a book of financial assets that constitutes a huge liquidity cushion. The Morgan parent, in fact, is as close to beatitude as any bank holding company is likely to get, so this rating is bad news to other sound holding companies — U.S.-owned, that is. In my opinion, the Moody's prejudice has always been unreasonable, and may now, since Oklahoma, be out of control.

The holding company problem, of course, is also a leading cause of the rating gap between foreign and U.S. international banks. Since the typical offshore holding company, where it exists, is usually an operating bank as well, the cash flow constraint is not

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